

Insights

U.S. SUPREME COURT: COURTS MUST CONSIDER GENERIC NATURE OF STATEMENTS IN WEIGHING CERTIFICATION OF SECURITIES CLASS ACTION, BUT DEFENDANTS BEAR BURDEN IN REBUTTING PRICE IMPACT

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SUMMARY

In a closely followed case concerning class certification in securities fraud class actions, the U. S. Supreme Court has held that the generic nature of a company's statements should be considered in determining whether such statements had an impact on the company's stock price. The Court also held that in opposing class certification, a securities fraud defendant bears the burden of showing that an alleged misstatement had no effect on the company's stock price.

The decision came earlier this month in *Goldman Sachs v. Arkansas Teachers Retirement System*, a securities fraud action which arose out of the 2008 financial crisis. In 2010, Goldman Sachs shareholders brought an action under Section 10(b) of the Securities Exchange Act of 1934 in the Southern District of New York, alleging that Goldman Sachs maintained an inflated stock price between 2006 and 2010 by making material misstatements about its conflict of interest policies and practices.

After Goldman Sachs unsuccessfully moved to dismiss the case, plaintiffs moved to certify a class under the fraud-on-the-market theory previously adopted by the Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Under that theory, securities fraud plaintiffs seeking to certify a class do not need to demonstrate individual reliance on a defendant's misstatements, based on the presumption that the market price reflected consideration of all material information. Once a plaintiff makes a showing that he or she is entitled to the *Basic* presumption, a defendant can rebut the presumption by demonstrating that the alleged misstatements had no effect on the company's stock price.

Thus, the ability of a defendant company or individual to rebut a claim of stock-price impact is a crucial issue for class certification.

After two visits to the Second Circuit on the issue of class certification – the District Court first certified the class, the Second Circuit remanded for further consideration of Goldman Sachs’ evidence, the District Court certified the class again, and the Second Circuit affirmed – the case reached the Supreme Court.

At issue were company statements such as “integrity and honesty are at the heart of our business.” Goldman Sachs contended these kinds of statements were too generic to affect the stock price. And it argued that in affirming class certification and rejecting defendants’ lack-of-price-impact arguments, the Second Circuit erred in two ways: (1) by ignoring the generic nature of the alleged misrepresentations in determining whether they affected the stock price, and (2) by placing on the defendant the burden of persuasion, rather than the lesser burden of producing some evidence, to prove a lack of price impact at the class certification stage.

On the second issue, the burden of proof, the Court rejected Goldman Sachs’ argument, and held that the defendant bore the burden of persuasion on that point, though it emphasized that the allocation of burden will rarely be determinative of the outcome of a class certification motion.

On the first issue, generic statements, the Court did not adopt a sweeping new legal principle, but instead noted that in briefing and arguing the appeal, “the parties’ dispute has largely evaporated.” Thus, it said, plaintiffs did not contend that courts at the class certification stage were barred from considering the generic nature of an alleged misstatement, but rather plaintiffs agreed that the generic nature of a statement “often will be important evidence of price impact,” since general statements are presumably less likely to influence stock buyers than more specific ones. The Court further noted that both parties agreed that courts could consider expert testimony and use their common sense in deciding whether a generic statement had a price impact. In effect, the Court said, there was nothing much on this issue for it to decide.

But, the Court said, it was not clear from the Second Circuit’s opinions whether it had considered the generic nature of the statements in holding that there was sufficient price impact to support class certification under the fraud-on-the-market theory. It therefore remanded the case, directing the Second Circuit to “take into account *all* record evidence relevant to price impact regardless whether that evidence overlaps with materiality or any other merits issue.”

The uncertainty about what the appeals court considered arises from the fact that the generic nature of statements may also be relevant to the issue of whether the statements are material, as is required for liability under Section 10(b). The Court had held in an earlier case, *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013), that plaintiffs seeking to invoke the fraud-on-the-market theory for class certification did not need to show materiality, which they did not have to prove until trial on the merits of a case. That remains the law, but the Court in *Goldman Sachs* made clear that just because the generic nature of the statements would be relevant to the merits issue of materiality, that does not mean a court at the class certification stage

should ignore the generic nature of the statements in determining whether they affected the company's stock price.

The majority opinion by Justice Amy Coney Barrett elicited two separate dissents. Justice Sonia Sotomayor dissented from the decision to send the case back to the Second Circuit, contending that a fair reading of the Second Circuit's opinion showed that it did consider the generic nature of the statements in reaching its decision.

Justices Samuel Alito, Neil Gorsuch, and Clarence Thomas dissented from the Court's ruling on the burden of proof issue, contending that "nothing in our prior decisions has ever placed a burden of persuasion on the defendant with respect to any aspect of the plaintiff's case."

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